In the

United States Circuit Court of Appeals

For the Ninth Circuit

No. 8835

FIDELITY AND GUARANTY FIRE CORPORATION, of Baltimore, a corporation,

Appellant,

vs.

WILLIAM E. BILQUIST, JOHN MYHRE AND SIGNE MYHRE,

Appellees.

UPON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF WASHINGTON, NORTHERN DIVISION.

APPELLANT'S REPLY BRIEF

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ARGUMENT

I.

DEFENSE NOT BASED ON MISTAKE IN DESCRIPTION

The argument that the appellant is estopped to say that the agent's mistake in describing the property insured can now be made a defense to this action is at

least an inaccurate statement of the character of the appellant's defense. (Answer brief, p. 3).

The description of the property insured is: "The two-story, shingle roof, frame building, and additions in contact therewith, situate on Lots 1 and 2 of Block 4, and Lots 8 and 9 of Block 5, of Davis Addition to Manchester, Washington." Pltf. Ex. 1 (Tr. 73).

The description of the property, so far as we know, contains no mistake, and no mistake of description has been or is now asserted as a defense.

The defense is not based upon description of the property insured, but upon the fact that the insured property was not being used in such a manner as to bring the loss within the appellant's undertaking.

Notwithstanding that the undertaking of the appellant was to insure the property while occupied only for dwelling house purposes (Tr. 72), the appellees used it for a hotel and as a place for the vending of beer and wine. Upon this the appellant bases its defense. This is not a matter of description.

II.

IMPUTING AGENT'S KNOWLEDGE TO PRINCIPAL

We have no quarrel with the general statement that knowledge of an agent is imputed to his principal; but

that principle has no application in this case. The loss not being within the coverage of the policy, there could be no recovery on the policy even had it been written by the executive officers of the company having all the knowledge the agent in this case is shown to have possessed. Where there can be no recovery on a contract without reformation, it can make no difference whether knowledge of the existence of claimed facts is derived by the insurer by direct information or by imputation of law.

III

ESTOPPEL — REFORMATION

The brief of appellees would indicate that their counsel has failed to recognize the fact that the decisions of the Supreme Court of Washington divide the defenses which have been made to policies of insurance in the cited cases into two classes:

First. Where the defense is that the policy has become forfeited by a breach of a warranty or condition thereof and is no longer in force and effect.

Second. Where the defense is that although the policy be in full force and effect, yet the plaintiff may not recover thereon, because the loss is not within the undertaking of the insurer—sometimes expressed as not being within the coverage of the policy.

Of the first class, are the following cases cited by appellees: *Gattavara v. General Ins. Co. of America*, 166 Wash. 691, 8 P. (2d) 421, cited on page 7 of the answer brief, where the defense was upon a warranty of sole and unconditional ownership; *Turner v. American Casualty Co.*, 69 Wash. 154, 124 P. 486, cited on page 8 of the answer brief, where the defense was the breach of a warranty of sound condition; *Stebbins v. Westchester Fire Ins. Co.*, 115 Wash. 623, 197 P. 913, cited on page 9 of the answer brief, where the defense was that the policy was void because the interest of the insured was not truly stated, and increase of hazard (p. 625); all of which forfeited the policy.

Of the second class, are the cases of *Carew, Shaw and Bernasconi v. General Casualty Co.*, 189 Wash. 329, 65 P. (2d) 689; and *Charada Inv. Co. v. Trinity Universal Ins. Co.*, 188 Wash. 325, 62 P. (2d) 722. In these cases the defense did not rely upon a forfeiture of the policy, but relied upon the defense that the loss was not within the defendant's undertaking under the policy.

The essential distinction between the two classes of cases is that in case of a defense which entails a forfeiture of the policy because of a breach of an undertaking of the insured that certain conditions exist, or shall not exist, such as sole and unconditional owner-

ship, no other contract of insurance, increase of hazard, incumbrance by chattel mortgage, etc., and that a breach shall make the policy void, then, where the true facts were known to the insurer, it may be prohibited from forfeiting the policy under the doctrine of estoppel; but where the defense does not seek to forfeit the policy, and, admitting its continued existence, it appears that payment of the loss is not within the insurer's undertaking, recovery may be had only in case the policy is so reformed as to bring the loss within the terms of the insurer's undertaking.

Where recovery can not be had under the policy as written—and it can not be had here, because the coverage is limited to an occupation only for dwelling house purposes—and the insured claims that the policy does not state the true contract, reformation is the only relief possible.

Carew, Shaw and Bernasconi v. General Casualty Co., 189 Wash. 329, p. 335; 65 P. (2d) 689.

The case of *Harper v. Firemans' Fund Insurance Co.*, 154 Wash. 77, 280 P. 743, was a case falling within the first class. The policy insured lumber in a lumber yard. There was no restriction upon the coverage, as in the case at bar where the property is covered only while used for a particular purpose. The policy contained a warranty of a clear space of 300 feet

around the lumber. This clear space was not maintained, and the policy, if there had been nothing more, would have been subject to forfeiture. Before the fire the insured was notified that the rate would be raised from $2.00 to $7.20, which was the applicable rate where there was no 300 foot clear space. The court says that the evidence clearly warrants the conclusion that the $7.20 rate was by agreement thereafter to be charged, and that it was the intention of the insured to pay the proper rate and obtain a policy which would protect him in case of loss if the 300 foot clear space was not maintained.

This case is clearly an instance of the application of the doctrine of estoppel to prevent the enforcement of a forfeiture, and not a case of allowing a recovery contrary to the coverage of the policy.

The case of *Miller v. United Pacific Casualty Ins. Co.*, 187 Wash. 629, 60 P. (2d) 714, cited on page 6 of appellees' brief, aside from the question of forfeiture because of a warranty of unconditional ownership, which was held unenforceable because there was no intent to deceive, is purely and solely a suit to reform the contract to meet the agreement of the parties and to recover upon the reformed contract. In the prayer of the complaint the insured asks for reformation of the policy to cover the true intent of the parties.

We have never contended that if the policy in the case at bar did not express the true agreement of the parties, it could not be reformed, unless to reform it would make of it a prohibited contract. We do contend that it can not be reformed in a proceeding where the issue of reformation is not raised.

The defendant was not bound to meet any issue not raised by plaintiffs' complaint. It had as much right to meet and defend the issue of reformation—not only whether it should be reformed, but how it should be reformed—as it had to meet the issue of execution and delivery and the amount of liability thereunder.

The complaint in the case at bar does not ask for reformation. It contains no allegation of how the policy should read when reformed. It contains no offer to pay the proper rate of premium on the policy, if reformed.

The trial court entered no judgment reforming the policy. It was tried in the Federal Court as a case at law and before a jury. No request was made by appellees to have it set to the equity side of the court.

If the policy is to be deemed to have been reformed, what parts of it are to be considered changed, and how changed?

What about the proper rate for insurance covering a hotel? There has been no offer to pay it, and no order of the court that appellees do pay it.

What about the period for which the policy, as reformed, should run? If the policy is reformed to cover a hotel instead of a dwelling house, the new policy must be subject to the rules laid down by the Washington Surveying and Rating Bureau.

"An unprotected dwelling can be written for three years for two and one-half annual premiums, while a beer parlor can be written only on an annual basis" (Tr. 128). If the reformed policy was to be a three-year policy, it would seem to be a prohibited policy; if a one-year policy, it had expired before the date of the fire. There is no middle ground.

If it be conceded—which it is not—that this policy should be treated as a reformed policy for the term of three years, still, under the state authorities, this judgment must be reversed.

In the case of *Miller v. United Pacific Casualty Ins. Co.*, 187 Wash. 629, 60 P. (2d) 714, the case which we have just been discussing, the Supreme Court of Washington lays down the rule upon one point involved in the reformation of policies of insurance. It says:

"Respondent will, of course, be entitled to receive or deduct the amount of the added premium consequent upon the reformation." (p. 641) (Italics ours.)

The premium paid upon the $4000.00 policy was $77.00. Computed upon a reformed policy to cover a hotel, for three years, the rate would be $3.46 per hundred for each year, or $138.40 per year; or $415.20 for the term. Deducting the premium already paid, the appellees are required to pay, or have deducted from any recovery, the sum of $338.00 with interest thereon from the 10th day of August, 1935—the date of the policy.

There now stands of record this judgment against the appellant, now brought before this court for review, which unless reversed, will completely settle all rights of the parties growing out of this policy of insurance, and which takes no cognizance of the right of defendant to receive the proper premiums, if this policy is to be treated as reformed.

Justice and equity can be done only by a reversal.

In the "Miller" case which we have been discussing, where reformation was asked, the Supreme Court of Washington, although it found the respondent entitled to prevail, reversed the case because the trial court had not taken into consideration the proper pre-

mium upon the risk under the reformed policy.

Miller v. United Pacific Casualty Co.,
187 Wash. 629; 60 P. (2d) 714.

The appellees cite the case of *Reynolds v. Canton Insurance Co.*, 98 Wash. 425, 167 P. 1115, and quote just enough of it to make it appear as an authority for a so-called legal principle which it distinctly does not support. It is true that the question involves the same boat, and a substantially similar marginal clause, involved in the "Pacific Marine Ins." case, although not the same clause, because it was written on different policies issued by different insurance companies. In that case—*Reynolds v. Pacific Marine Insurance Co.*, 98 Wash. 362, 167 P. 745—it was conceded "that the clause was not wrongfully or fraudulently inserted, but was done with the authority and permission of the insured, and prayed a reformation of the contract by striking out the clause.

The "Canton" case was decided entirely upon the theory that the disputed marginal notation, if valid, worked a forfeiture of the entire policy, and that an estoppel may be asserted against the insurance company to prevent it from making such a defense. It does not present a question of whether or not a recovery may be had upon the policy as written contrary to the undertaking of the insurer. It involves

only a promise or undertaking of the insured that he will not do a certain thing. It may render the policy void if violated; and all the "Canton" case holds is that there was an estoppel to forfeit the policy. It does not hold that estoppel may be employed to extend the undertaking of the insurer under the policy. If it does, it must be considered to be overruled by the recent cases of *Carew, Shaw and Bernasconi v. General Casualty Co.*, 189 Wash. 329, 65 P. (2d) 689; and *Charada Investment Co. v. Trinity Universal Ins. Co.*, 188 Wash., 325, 62 P. (2d) 722.

The insurer is entitled to stand on his contract under the policy as written. It may be estopped from enforcing a forfeiture of the policy because of a violation of the insured's undertaking, but estoppel will not enlarge the insurer's undertaking.

The appellees plant themselves squarely upon the contract of the policy as written. They sued upon it as written. They did not seek its reformation. Although in their answer brief they tried to "back" the idea of reformation into the case, by citation of authorities that reformation and recovery on the policy may be had under the state practice in the same action, yet they have cited no authority, and there is none, that reformation may be had without showing that there was another agreement than the one con-

tained in the policy. One statement contained in the appellees' brief states the truth, and its statement utterly destroys any assumption that claim was made for reformation, or showing made of a different agreement from that contained in the policy.

"*Neither did we attempt to show any other agreement than that contained in the policy.*" (Appellees' brief p. 11). We have italicised the quotation because of its significance.

There can be no reformation and no recovery unless the existence of a different contract is shown.

The question of how the issue shall be tried in the Federal courts is a question involving the organization of the Federal judiciary system, and is controlled by the laws of the United States and not by those of the state wherein the cause of action arose.

IV
THE COVERAGE OF THE POLICY

Appellant's brief cited cases from the Supreme Court of Washington to the effect that estoppel can be applied only where the defense is that there has been a forfeiture of the policy by breach of a condition or warranty, and can not be used to bring into being a liability contrary to the express provisions of the contract (Topic B, page 24).

A desperate attempt is made by appellees to distinguish these authorities. Discussing *Carew, Shaw and Bernasconi v. General Casualty Co.*, 189 Wash. 329, 65 P. (2d) 689, on page 10 of the answer brief they attempt to distinguish upon two grounds:

First. That the court's statement that estoppel may not bring into existence a liability not within the coverage of the policy, is limited to cases where the result would be to insure a thing not insured.

Second. That the decision is not in point, because the court did not find any fraud or mistake.

The first basis of the claimed distinction is that the action in that case was brought to extend the coverage to something other than the thing insured in the policy. Pursuing this line of argument, appellees say:

"The cases relied upon by appellant are cases where it is attempted to show that something other than that contained in the policy was insured; *that is, some other thing, or the same thing at some other or different location.*" (Italics ours.) (P. 12 of answer brief.)

The appellees seek to limit the term "coverage" solely to the actual thing which may be the subject of the loss, disregarding the fact that the limitations

upon the use to which the insured property may be put, and the time in which the loss must occur, all of which, as the court said, "*are events and conditions which under the terms of the policy must occur to obligate the insurance company to pay the loss*" (Italics ours) (p. 335 of above cited case), are as much a part of the coverage as the description of the physical property which may be the subject of a loss.

Extending their theory, the appellees claim the "Carew" case (supra) to be inapplicable because the policy insured a box inside a safe, while the contention was that the agreement was for the entire safe, and therefore the subject matter was not the same; and they contend that the doctrine announced in the "Carew" case is applicable only where applied to a distinct article, as a different house, or furniture in a different house, or a house on a different lot, and that it can not be applied to a limitation on coverage. Notwithstanding that the court in that case said, "Patently in the absence of events and conditions which, under the terms of the policy, must occur and exist in order to obligate the insurance company to pay the loss, the appellant could not recover under the policy as written" (p. 335), and that the words "events" and "conditions" clearly do not refer to the identification of the property itself, but to those limitations under

which alone the insurer will be liable—in this case, the use only for dwelling house purposes—, the appellees still claim that the opinion of the Supreme Court of Washington in the "Carew" case applies only to cases where the policy describes one property and the loss is of another.

For the purpose of determining whether appellees' interpretation of the application of the "Carew" case conforms to the intention of the Supreme Court of Washington, we propose an examination of the case of *Charada Investment Co. v. Trinity Universal Ins. Co.*, 188 Wash. 325, 62 P. (2d) 722, cited on page 335 of the opinion in the "Carew" case (supra), and see how fares the claim that the rule applies only where a distinction exists such as appellees draw between a safe and a box inside a safe, which appellees say are two different things or places.

In the "Charada" case the action was brought to reform a policy of insurance on a safe and its contents and to recover thereon as reformed. The information given to the agent was that a policy was desired which would protect valuables in the safe at all times, particularly during business hours when the door would remain open. The agent agreed to furnish such a policy. The coverage of the policy delivered (p. 329) insured against loss by persons making entry while the safe

"*is duly closed and locked*" (Italics ours). After the outside door of the safe had been opened by an authorized employee of the insured and remained open, the safe was burglarized and a compartment therein forcibly opened and money extracted. The distinction did not exist in that case which appellees seek to raise as to the "Carew" case. The safe referred to in the policy was the same safe that was burglarized. The coverage of the safe covered the compartments into which its interior was divided. The Supreme Court said the trial court correctly held that the insured whose money was taken from the box in the safe could not recover upon the policy as written, not because the safe and the box inside it were two different things or places, but "*because the safe was not closed and locked*" (Italics ours)

There is no legal distinction between a coverage clause in a policy that loss shall be payable only in case of a burglary while the door of the safe is closed and locked, and one providing that a loss of a house shall be payable only when at the time of such loss the house is being used only for dwelling house purposes. Both provisions are part of the coverage of the policy.

In *Lundeman v. United States Fidelity and Guaranty Co.*, 163 Minn. 303, 204 N. W. 159, the plaintiff claimed that the arrangement between him and the

agent of the insurance company was for a policy which would cover a loss sustained by the abstraction of valuables from his safe when it was opened by the owner under duress of robbers. The policy delivered to the plaintiff covered a loss only when occasioned by a forcible entry or entry by violence into the safe, of which force and violence there must be visible marks upon the safe, made by tools, explosives, chemicals or electricity. The owner was forced by robbers under threats of physical injury to open the safe and the robbers took valuables therefrom. It was the same safe referred to in the policy and the same safe involved in the contemplated agreement claimed by the insured to have been made with the agent which would have covered an entry procured by the exercise of duress.

The court said: "Of course the entry to the safe in the manner testified to by the plaintiff was not covered by the policy he received."

That case is cited with approval by the Supreme Court of Washington in the case of *Carew, Shaw and Bernasconi v. General Casualty Co.* (supra).

It appears that the manner in which a safe was to be opened in order for liability to attach, was a matter of the coverage of the policy. There can be no distinction between it and a provision as to the character of

the use of property upon which liability shall depend. Both are part of the coverage of the policy.

Nothing is said in the opinion in the case of *Gattavara v. General Insurance Co. of America*, 166 Wash. 691; 8 P. (2d) 421, cited on page 12 of the answer brief, which at all detracts from the rule laid down in the "Carew" case that estoppel can not be employed to extend the coverage of a policy. The question involved in the "Gattavara" case was not one of whether the loss was within the coverage of the policy, but was one of whether, in case of a breach of warranty of "sole and unconditional ownership," estoppel could be asserted to prevent a forfeiture of the policy. Mention is made in the answer brief in connection with the reference to this case that the defendant had failed to return or tender a return of the premium. In the case at bar the amount of the premium, with interest, was tendered (Tr. 38, par. VII) and refused (Tr. 53, par. VIII).

The second basis of distinction urged—the failure to find fraud or mistake in the "Carew" case—is a distinction not in point. The only materiality of fraud or mistake was upon the question of reformation. Neither fraud nor mistake is ground for a recovery contrary to the coverage of the policy sued upon.

V

INCREASED HAZARD

Under this title of their brief, the appellees make some statements which should not go unchallenged.

On page 15 it is stated that there was no evidence that a dwelling was changed into a roadhouse. There is no sinister meaning attached to the term "roadhouse." It simply means a place of public entertainment whose patronage comes to it by way of the road. It applies as much to a hotel or restaurant as to a place where any other form of public entertainment is offered.

We do contend that—the building being insured only while occupied for dwelling house purposes, and at the time of the fire being used as a beer parlor—there has been such a change of use from that for which it was insured as to increase the risk and the rate, as pointed out in *Allen v. Merchants Fire Assurance Corporation*, 179 Wash. 188, 36 P. (2d) 545, at page 194 of the official report.

On page 18 of appellees' brief the statement is made: "It must be remembered that the appellant did not insure a dwelling, but insured the building for the uses and purposes for which it was being used." This is a misstatement. The policy itself shows what the

appellant insured. It insured a two-story, shingle roof, frame building, located as described, "*while occupied only for dwelling house purposes.*" (Tr. p. 73.)

The contract, until reformed, is the sole evidence of what was insured and what the conditions of the insurance were. It certainly does not follow, as argued by the appellees, that because we are bound by this policy, and estopped from disputing it, we are estopped from claiming that the use of the insured property, to warranty a recovery, should be in accordance with the provisions in the coverage of the policy.

The appellees made no objection to the inquiry of the adjuster and the general agent as to the increased risk of a beer parlor over a dwelling, either as to their competency or as to the admission of opinion evidence. We still contend that the evidence stands uncontradicted. The testimony cited on pages 18 and 19 of appellees' brief does not eliminate the question of increased hazard. There may be a hazard avoiding the policy, although that hazard did not cause the fire. There may be no hazard in a bar, and a great amount of hazard from the crowds who flock to a beer parlor.

There seems to us one unescapable answer as to whether there was increased hazard. Under the rates

made by authority of law, the rate on the dwelling was $1.10 and on a hotel or beer parlor $3.46 (Tr. 129 and 127-128). Why the higher rate if there was no increased hazard?

VI
INTEREST

In answer to appellees' contention (answer br. p. 20) that the allowance of interest was never objected to and that this matter was never raised in the lower court, we refer this court to the judgment on page 69 of the Printed Record, where this appellant was allowed its exception because of the inclusion of interest.

The case of *Yarno v. Hedlund Box and Lumber Co.*, 135 Wash. 406, 237 P. 1002, cited in appellees' brief, page 21, is not a decision that has any bearing upon the right of a court to add interest to the verdict of a jury. In that case there was a breach of a contract under which certain sums were payable at specified times. Upon the breach, suit was brought and judgment recovered, including the payments due in the future. Holding that the worth of the sums payable in the future was more at the time of the judgment than at the times when they were payable, the case was remanded to the lower court to determine the value at the time of the judgment of the amounts payable under the contract in the future.

Yarno v. Hedlund Box and Lumber Co.,
129 Wash. 457; 225 P. 659; 227 P. 518.

The matter came again before the court in the case cited in appellee's brief, for the purpose of determining the present worth at the time of the judgment of the future payments which plaintiff was entitled to receive. The court said:

"*No claim is made here for interest prior to the rendition of the original judgment.*" (Italics ours).

The sole testimony of the value of the personal property was that of Mrs. Bilquist, an interested party, whose husband was a plaintiff, and who made no showing that she had any knowledge of the value of such property.

The jury was not bound to accept her valuation. They were at liberty to use their own judgment upon values.

Perhaps even the jury was not sufficiently credulous to believe that bar fixtures and equipment, water pumps, dishes and silverware service for 40 persons, and 8 sets of dining tables and chairs, were the "household furnishings and personal effects" covered by the policy (Tr. 74). It may have eliminated enough of articles of that, or similar, character to enable it

to include interest in the verdict, without exceeding the amount returned.

The presumption is that, if the appellees were entitled to interest, the jury included it in their verdict.

The judgment must conform to the verdict.

The judgment should be reversed and judgment entered for the appellant. Even though the appellees were to prevail, a reversal and remand would be necessary because of the right of appellant, under the laws of the state, to have the difference between the proper premium for the risk and the premium actually paid, deducted from the judgment, and the provision granting interest prior to the judgment stricken therefrom.

Respectfully submitted,

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